IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 639

ESTATE OF MORTIMER B. FULLER, DEC. KATHRYN S. FULLER, EDWARD L. FULLER, MORTIMER B. FULLER, JR., and HENRY S. FULLER, Executors, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, AND BRIEF IN SUPPORT THEREOF.

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v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

The Estate of Mortimer B. Fuller, Deceased, (Kathryn S. Fuller, Edward L. Fuller, Mortimer B. Fuller, Jr., and Henry S. Fuller, Executors) respectfully prays for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit to review the judgment of that Court entered in the above cause on December 13, 1948.

NATURE OF CONTROVERSY.

This proceeding involves income taxes for the years 1942 and 1943 in the total amount $33,624.62 (R. 7a) under section 23(a)(2) of the Internal Revenue Code (Appendix, p. 1a), which allows as a deduction all of the ordinary and necessary expenses incident to the management, conservation, or maintenance of property held for the production of income; and alternatively, section 23(a)(1) of said Code, allowing as deductions all of the ordinary and necessary expenses paid in carrying on any business.

The Tax Court (R. 17a) denied the deductions under both sections of the law and the Circuit Court of Appeals (R. 31a) affirmed in a *Per Curiam* decision of two lines.

STATEMENT OF FACTS.

Petitioner is an Estate still in the period of administration. (R. 22a, 26a). Mortimer B. Fuller, of Scranton, Pennsylvania, died testate on September 7, 1931. He designated his widow, Kathryn S. Fuller, and his sons, Edward, Mortimer, Jr., and Henry, as executors and trustees under his will. (R. 18a). His gross estate included stocks and bonds valued at $2,357,764.39,—chiefly 35,710 shares of International Salt Company (listed) and 2,119 shares of Genesee & Wyoming Railroad Company (unlisted), of both of which companies he was President. All of these two blocks, representing control of both companies, were pledged at decedent's death to banks and individuals as collateral on notes aggregating $1,839,783.83 and remained so pledged during all times material here. At the end of the period involved, the Estate had reduced the secured debts to $520,822.73. (R. 8a).

The family residence, known as Overlook, was inherited from decedent's father and was occupied by the entire family in separate homes at decedent's death and throughout the period involved. (R. 27a). By his will, decedent devised to his widow a life estate in Overlook and be-

queathed to her, for her life, all cattle, horses, equipment and appurtenances thereto. All of the residue of the estate, real, personal, and mixed, he left to the trustees, first to set aside a portion sufficient to produce an annual income to be applied to the maintenance and operation of Overlook and all things incident thereto, during the life of his widow. (R. 18a). Should the widow and all of the sons so desire, she and the trustees were to sell Overlook, the proceeds to be retained by the Trust Estate. After her death, should the sons so desire, the trustees could sell and distribute the proceeds to them or their heirs. The income on the balance of the entire Trust Estate was to be paid annually to the widow (5/8ths) and to each son (1/8th), during her life; and on her death the corpus and accumulated income were to be distributed to the said sons. (R. 19a).

Except for small cash legacies to servants, no distributions whatever had been made to and including the period under review. (R. 22a).

Overlook was a country estate of about 518 acres. The farming and dairy business was conducted under an employed superintendent and force. (R. 24a). Produce was sold both to the family and the public, the family paying the same price paid by the public, also paying all of their own domestic expenses. The records were kept carefully and farm assets and supplies kept segregated from residential items,—even to separate gasoline pumps. There were numerous buildings, some occupied by the help and one of which was rented to an outsider. (R. 25a).

No new buildings or facilities were added to the premises subsequent to decedent's death, except one chicken coop. (R. 29a). All receipts, including rent, were paid to the Estate and so reported for tax purposes. (R. 22a, Ex. 6, 8). In 1939, a portion of the realty was sold by the Estate and the proceeds were received and held by it. (R. 25a, Ex. 15). Maintenance expenses were curtailed until in one year

they were only a third of those paid during the decedent's life. (R. 28a).

Against receipts, the Estate paid a total of $23,068.58 in 1942 and $22,999.68 in 1943 on the farming operations alone, including the depreciation on equipment, and claimed the same as deductions itemized on the schedules attached to the tax returns. (R. 22a, Ex. 6, 8). The Commissioner disallowed the deductions.

The Estate appealed to the Tax Court on two grounds; first, that the payments were ordinary and necessary expenses paid for the management, conservation and maintenance of property held for the production of income as provided in section 23(a)(2) of the Internal Revenue Code; and, alternatively, as ordinary and necessary expenses paid in carrying on the business of farming, under section 23(a)(1) of that Code. (R. 7a).

In sustaining the Commissioner, the Tax Court made no ultimate finding whatever as to the alternative issue, and its finding on the first issue can be gathered only from the opinion.

The Estate appealed and the CCA-3 affirmed the Tax Court in a *Per Curiam* decision of two lines. (R. 31a).

REASONS RELIED UPON FOR ALLOWANCE OF THE WRIT.

1. The decision of the Circuit Court of Appeals for the Third Circuit, in so affirming the decision of the Tax Court, disallowing the deductions under section 23(a)(2) of the Internal Revenue Code on the basis of technical title rather than the duty of executors, is in conflict with the decision of this Court in *Bingham's Trust*, 325 U. S. 365; 89 L. Ed. 1670.

2. The decision of the Circuit Court of Appeals, in affirming the decision of the Tax Court, which failed to make specific findings of ultimate facts, is in conflict with the decision of this Court in *U. S.* v. *Pyne*, 313 U. S. 127; 85 L. Ed. 1231.

3. The decision of the Circuit Court of Appeals, in denying deduction of compulsory expenses paid by an Estate for conservation of property held, is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *Commissioner* v. *Plant*, 76 Fed. (2d) 8.

4. The Circuit Court of Appeals has so far departed from the accepted and usual course of judicial proceedings and sanctioned such a departure by the Tax Court as to call for an exercise of this Court's power of supervision.

WHEREFORE, your petitioner prays that a writ of certiorari issue to the U. S. Circuit Court of Appeals for the Third Circuit, commanding said Court to certify and send to this Court, on a day to be determined, a full and complete transcript of the record of all the proceedings of such Circuit Court of Appeals had in this cause, to the end that this cause may be reviewed and determined by this Court; that the judgment of the Circuit Court of Appeals be reversed; and that the petitioner be granted such other and further relief as may seem proper.

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IN THE

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No.

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v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

BRIEF IN SUPPORT OF PETITION.

OPINION BELOW.

The opinion of the Tax Court (R. 7a) is reported at 9 T. C. 1069. The opinion of the Circuit Court of Appeals (R. 30a) was rendered December 13, 1948, and is reported at 171 Fed. (2d) 704.

JURISDICTION.

The jurisdiction of this Court is invoked under section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (28 U. S. Code, section 347).

STATEMENT OF THE CASE.

The principal facts are set forth in the petition at pages 2 to 4.

SPECIFICATION OF ERRORS.

The Circuit Court of Appeals erred in affirming without comment the following errors of the Tax Court:

1. That Pennsylvania executors, who also were trustees and remaindermen, acquired no duty to manage, conserve and maintain real and personal property during the period of administration and life tenancy.

2. That such expenditures were not for the management and conservation of property held for the production of income under section 23(a)(2) of the Internal Revenue Code, in conflict with *Bingham's Trust* v. *Commissioner*, 323 U. S. 365.

3. In failing to make ultimate findings of facts as to either issue.

4. In considering losses as a test.

5. In indulging in speculation as to a purpose contrary to the direct evidence and against the presumption of regularity in the acts of fiduciaries and representatives of the courts.

STATUTES AND REGULATIONS INVOLVED.

The statutes and regulations involved are set forth in full in the appendix, *infra*, page 1a.

ARGUMENT.

1. The Holding That the Executors Acquired No Duty to Manage, Conserve and Maintain the Property.

The erroneous premise upon which the Tax Court's entire decision rests is the finding (R. 13a) that "the decedent gave the executors *(sic)* no duty to manage, con-

serve, or maintain Overlook" and that "they acquired no jurisdiction over it * * * under the laws of Pennsylvania." The Tax Court indulges in that refinement of technical titles which has so many times and even recently engaged the attention of this Court. *Commissioner* v. *Church's Estate,* 69 S. C. L. 322, 327 in dealing with the overruling of *May* v. *Heiner,* 281 U. S. 238, which had fixed a rule upon the test of formal legal title. Even that has been disregarded here as to the maintenance of undistributed personalty.

Consideration below centered on title to the realty, nowhere recognizing that there was still in the custody of the Estate, during the period of administration, substantial undistributed personalty of a character requiring immediate care. (R. 27a). This is the first and very apparent error.

Cattle, horses, hogs, chickens, crops and equipment must be sheltered and tended instantly and both the duty and responsibility rested with the Estate, at least until the personalty had been distributed. Had fences not been kept in repair and roving cattle caused damage to adjacent property before distribution, the Estate would have been answerable, not the legatee who had not received the property. Had there been no will, these expenses would have been compulsory upon the Estate during administration, meaning the executors. The trust had not been set up and could not be set up until the corpus was released from pledge, (R. 22a) and the life tenant did not yet have delivery.

But the premise also is erroneous in relation to the realty. Throughout, executors rather than the Estate were considered by the courts below. The tax entity is the Estate, not the executors or trustees. Sections 161, 162, Internal Revenue Code. (R. 1a). Tax deductions apply only to the tax entity, not to the individuals acting for the entity. During the period of administration, the Estate could act only through the executors. When they ceased

to act, the Estate would continue to act through the trustees. Whatever duty or power was given to the trustees by the will or the law necessarily applied to the executors during administration. The trustees were given the specific duty to incur the expenses. (R. 18a). The premise that the decedent gave no duty to the executors is specious and contrary to the evidence as well as the law.

Under the specific terms of the will (R. 18a), title to the remainder in the realty was in the trustees of the estate. Except for the life estates in the realty and the undistributed personalty, the Estate was given the large security holdings, the very first duty specified being the "maintenance and operation" of Overlook. (R. 18a). The trust could not be set up until the intended corpus was released from pledge and distributed to the trustees. (R. 25a). The Tax Court endeavors to make a distinction based upon the two representative capacities where, in tax law, there is no difference. The Tax Court has confused an executrix with the person acting as such, contrary to *U. S.* v. *Britten,* 161 Fed. (2d) 921; *Caro duB. Alston* v. *Commissioner,* 8 T. C. 61; *Garrett J. Donnelly* v. *Commissioner,* 31 B. T. A. 577; *Est. of J. Armstrong* v. *Commissioner,* 2 T. C. 731; *Walter A. Frederick* v. *Commissioner,* 2 T. C. 936. The distinction for tax purposes between heirs or beneficiaries from the estate or trust is as clear as that between a stockholder and his corporation. See *Dalton* v. *Bowers,* 287 U. S. 404, 410; 53 S. Ct. 205, 207; 77 L. Ed. 389.

Although the Tax Court cites *Henry B. Plant* v. *Commissioner,* 76 Fed. (2d) 8, in connection with a point upon which the parties stipulated, (R. 12a) it overlooked and is in conflict with Circuit Judge Augustus Hand's holding there that the life tenant was not entitled to receive the sums expended, that the expenditures in maintaining the property may have been as much for the benefit of the capital of the trust (which was the remainderman here) as

for the enjoyment of the life tenant, and the fact that the expenditures were compulsory.

The Estate from the start has dealt with the personalty as its own rather than the widow's. Income from not only the operation of animals and equipment, but also from sales thereof, has been treated as Estate income. (R. 22a, 25a, Ex. 6, 8, 15). This is consistent entirely with the terms of the will, under which the widow was given only the use of the personalty "for and during the term of her natural life." Under Pennsylvania decisions this continued and uniform construction of the will by all interested parties becomes the law of the case and controls. *In re Catanach's Estate,* 273 Pa. 368; 117 A. 173. The payment of expenses of maintenance and operation of this personalty, therefore, is not only in accord with the specific directions of the will, but the law of the State.

The Overlook personalty not only was still in the custody of the executors, but upon its distribution to the life tenant she would be required by Pennsylvania law * to give

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* Act of June 7, 1917, P. L. 447, sec. 23: Title 20 of Purdon's Pa. Stat. Ann.; Sec. 635:

> "Whenever any person is or shall be entitled to the income from the proceeds of the sale of a decedent's real estate; and whenever any personal property, or the increase, profits, or dividends thereof, has been or shall hereafter be bequeathed to any person for life or for a term of years, or for any other limited period, or upon a condition or contingency; the executor or executors, administrator with the will annexed, trustee or trustees under such will, or trustee appointed by the orphans' court to make such sale of real estate, as the case may be, shall deliver the property so bequeathed to the person entitled thereto, upon such person giving security in the orphans' court having jurisdiction, in such form and amount as in the judgment of the court will sufficiently secure the interests of the person or persons entitled in remainder, whenever the same shall accrue or vest in possession. Should such person or legatee refuse or neglect, or be unable, to enter such security, the court may, upon petition of any person interested, including the owner of any subsequent interest, vested or contingent, in such proceeds of real estate, personal property, or the increase, profits, or dividends thereof, and upon due notice to

a bond for an accounting to the remaindermen. *Loewer's Estate,* 263 Pa. 517. Thereupon she would become a debtor to them. *In re: Gillett's Estate,* 130 Pa. Superior Court 309, 197 A. 517; *Powell's Estate,* 340 Pa. 404, 17 A. 391; *Letterle's Estate,* 248 Pa. 95. On her failure to give bond, they could have a trustee take over. The remaindermen here, as to both realty and personalty, were the trustees. All of this is in addition to the specific instructions in the will that the trustees (meaning the Estate, taxwise) should operate and maintain Overlook. The Tax Court's premise as to duty imposed by the decedent and that fixed by Pennsylvania law is erroneous.

2. Direct Conflict With Bingham's Trust, 325 U. S. 365; 89 L. Ed. 1670.

The nearest approach to a specific holding below is the statement, buried in the opinion (R. 13a) "The expenses were not ordinary and necessary expenses of the estate *(sic)* under section 23(a)(2)." Here for the first time the Tax Court mentioned the tax entity rather than the executors or trustees.

Bingham's Trust, supra, is the leading case on section 23(a)(2). In the case at bar, jurisdiction and title to the realty only, though carelessly discussed, are the purported

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all persons interested, so far as such notice can reasonably be given, appoint a suitable person or corporation as trustee to receive and hold such proceeds of sale or personal property, invest the same in securities authorized by law, pay the income thereof, after deducting all legal charges, to the person entitled thereto; and, upon the termination of the trust, account for and pay to the persons entitled thereto the corpus of the trust fund, or transfer and deliver to them the securities in which it is invested, as the court may direct, after deducting all legal charges thereon. Such trustee shall enter such security as the court may direct. He shall not be an insurer of the trust fund, and shall be liable to the persons interested in the income or corpus of the trust fund only for such care, prudence, and diligence in the execution of the trust as other trustees are liable for."

bases for the conclusion reached. The *Bingham* decision, (325 U. S. at 373, 375) rests upon the duty to hold and conserve the property until final distribution, and it holds that any ordinary and normal expense incurred thereby is deductible under the section. In *Bingham,* the expenses had no direct relation to income production, being tax litigation expenses. In the case at bar, the expenses did directly produce income which was returned for tax purposes.

Bingham holds that expenses related to distribution are within the section. Our expenses not only produced income, but were for the conservation of real property ultimately to be sold by the Estate, part of which had been sold by it and all of the proceeds of the sale were and would be Estate income.

The expenses in the *Bingham* case were deemed compulsory under the legal duty of the trustees. Here they also had been directed by the specific terms of the will. Had they not been so disbursed, the life tenant and beneficiaries could have enforced their payment and, under Pennsylvania law, the executors would have been surchargeable had damage or loss resulted from their failure to make them. *In Re: Catanach's Estate, supra; In Re: Nagel's Estate,* 305 Pa. 36; 156 A. 309.

3. Failure to Find Ultimate Facts.

Nowhere in either the Findings of Facts or the Opinion below has there been any finding of the ultimate fact as to the alternative issue raised in the pleadings—"ordinary and necessary expenses paid in carrying on the business of farming."

Nowhere in the Findings of Facts has there been a finding, preliminary or ultimate, whether the expenses were "paid in the conservation, maintenance, or management of property held for the production of income," the ultimate fact under section 23(a)(2). Buried in the opinion is the statement that the expenses were not ordinary or

necessary expenses of the estate "under section 23(a)(2)." (R. 13a). This precisely is what this Court proscribed in *Crocker* v. *U. S.*, 240 U. S. 74, 78; 50 L. Ed. 533; and in *U. S.* v. *Pyne*, 313 U. S. 127, 130; 61 L. Ed. 893, 895; followed in *City of Goldfield* v. *Roger*, 249 Fed. 39; *Highway Trailer Co.* v. *Des Moines*, 298 Fed. 71; *Lahman* v. *Burnes National Bank*, 20 Fed. (2d) 897; and applied directly to the Tax Court in *Kendrick Coal & Dock Co.* v. *Commissioner*, 29 Fed. (2d) 559, 564.

In failing to make such ultimate findings, the decision below is in direct conflict with section 1117(b), title 26 U. S. C. A.; 53 Stat. 161, amended October 21, 1942, c. 619, Title V. section 504(a)(c), 56 Stat. 957.

On this point alone the decision below should be reversed.

4. Using Losses as a Test.

If the repeated references to losses, in the decision below, were intended to relate to the issue under section 23 (a)(2) they are immaterial under *Bingham's Trust, supra.* The Court below has so confused the two issues it is difficult at times to determine which section it was considering.

If such references were directed toward section 23(a)(1) as farming business losses, they still are immaterial under the plain provisions of the Commissioner's own regulations. Section 29.23(a)15, fifth sentence, Regulations 111. (R. 2a). *Thacher* v. *Lowe*, 288 Fed. 994, cited in the Tax Court's decision, has no relation because, as the Commissioner pointed out in G. C. M. 21,103, in 1939-1 C. B. 164, dealing with all of the "pleasure" farming decisions, in the *Thacher* case the only evidence submitted was a statement of receipts and losses. See *Cooke* v. *Commissioner*, 78 Fed. Supp. 519. The decisions cited by the Court below related to voluntary farming ventures. The activities involved here were compulsory and there was no alternative or option.

5. Substitution of Speculation for Fact.

As lately as October, 1947, Circuit Judge Kalodner, who sat in the present case, for the CCA-3 issued a decision which reversed the Tax Court for indulging in the very practice engaged in here. *In Re: Leuders' Estate,* 164 Fed. (2d) 128. He referred to a curious series of deductions, which in view of the record itself, failed to attain the dignity of factual inferences and could only be described as "hunches;" stating that there was not a single discernable statement in the record to support many of the Tax Court's reasonings; that while that Court had a choice as between conflicting factual inferences and conclusions considered most reasonable it was well settled that speculation cannot be substituted for proof (quoting from *Galloway* v. *U. S.,* 319 U. S. 372), and that this particularly is true where the speculation is unfavorable to the taxpayer, citing *Van Worst, Exec.* v. *Commissioner,* 22 B. T. A. 632, affirmed in 59 Fed. (2d) 677.

Another recent occasion where the Circuit Court of Appeals (6th) reversed the Tax Court for indulging in inferences and suppositions contrary to the clear evidence in the record, is *Kent* v. *Commissioner,* (September, 1948) 170 Fed. (2d) 131, 136-7; quoting the phrase used in *Lawton* v. *Commissioner,* 164 Fed. (2d) 383: "* * * out of such gossamer threads of circumstance that the findings and conclusions of the Tax Court are woven * * *", and citing this Court's discussion of "substantial evidence" in *Consolidated Edison Co. of New York* v. *N. L. R. B.,* 305 U. S. 197, 198; 59 S. Ct. 206, 217; 83 L. Ed. 126 and many other cases.

In the face of the direct evidence that the Estate representatives felt they had a responsibility to keep up the property as best they could in the condition in which they received it and regardless of its character; (R. 29a) the rule of law that holds executors and trustees responsible for such care or surchargeable should they not exercise it;

the fact that everything remained as prior to decedent's death except for retrenchment in expense; (R. 28a) and the specific directions of the will that the tax entity should incur the expenses; (R. 18a) the Court below speculated upon the executors "moving on to property" (R. 14a) where they always had been, and inferred the motive was to indulge in pleasures or hobbies (R. 16a) which are not permitted executors,—all without that "scintilla" of evidence referred to in *Consilidated Edison, etc., supra.* It inferred an ulterior personal motive and intention to individuals who had no discretion or option in their fiduciary capacity. It disregarded entirely the presumption that official acts or duties have been properly and legally performed, which presumption was recognized in the Tax Court's very first decision. *Parrott* v. *Commissioner,* 1 B. T. A. 1, affirmed in *Noel* v. *Parrott,* 15 Fed. (2d) 669; see also 31 C. J. S., section 146(a) and 146(c).

The holding here is contrary to the holding of the same CCA-3 in *Chandler* v. *Commissioner,* 119 Fed. (2d) 623, 625, stating as the fundamental principle underlying all fiduciary relationships that fiduciaries may not have personal dealings with the property held by them,—citing Restatement, Trusts, section 170 and comments thereto. In this *Chandler* decision, the CCA-3 held that the existence of separate legal entities seldom is ignored in tax matters and that it may not be presumed that corporate directors have given away as a gratuity a valuable right to use corporate property. 119 Fed. (2d) 626, 627. Ordinarily such action would be beyond their power,—citing *Noel* v. *Parrott, supra.*

The Tax Court here went to the extreme in finding (in its opinion) several facts as to use of certain facilities as to which there is not a solitary word or figure of evidence in the record. (R. 15a). It stated in the opinion there was no segregation of expenses, (R. 16a) when it already had found the segregation in detail in its own Findings of Fact. (R. 11a).

In so doing the Court below acted contrary to law and sufficiently so to warrant setting aside its findings. *Foran* v. *Commissioner,* CCA-5, January 20, 1948, in 165 Fed. (2d) 707, citing *Greene* v. *Commissioner,* 141 Fed. (2d) 645, 646. See also *Charles P. Tatt* v. *Commissioner,* CCA-5, at 166 Fed. (2d) 697.

CONCLUSION.

It is submitted that the decision of the United States Circuit Court of Appeals for the Third Circuit should be reversed, and that, to such end, a writ of certiorari should be granted and your Court review the said decision.

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v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 7a–16a) is reported at 9 T. C. 1069. The opinion of the Court of Appeals (R. 30) is reported at 171 F. 2d 704.

JURISDICTION

The judgment of the Court of Appeals was entered on December 13, 1948 (R. 31). The petition for a writ of certiorari was filed on March 11, 1949. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's decision that expenses of maintaining and operating a farm and homestead occupied by the executors as individuals are not deductible by the estate under Section 23 (a) (2) of the Internal Revenue Code as expenses incurred for the management, conservation, or maintenance of property held for the production of income, or under Section 23 (a) (1) as ordinary and necessary expenses incurred in carrying on any trade or business.

STATUTES AND REGULATIONS INVOLVED

These appear in the Appendix, *infra,* pp. 13–17.

STATEMENT

The facts as found by the Tax Court (R. 7a–12a) may be summarized as follows:

Mortimer B. Fuller died on September 7, 1931. He appointed his wife, Kathryn S. Fuller, and his three sons, Edward L., Mortimer B., Jr., and Henry S. Fuller executors and trustees under his will. (R. 7a.)

The executors bought and sold securities from 1931 through 1943 and received income on the securities held. The executors also owned, during that period, various listed and unlisted securities whose value was at all times substantially greater than the debts of the estate. The indebtedness owed to banks and individuals was gradually

reduced and on December 31, 1943, amounted to $520,822.73. The indebtedness to banks was increased $12,553.17 during 1942. No steps, except the reduction of debts and the payment of some cash bequests, were taken during the period to close the administration. No accounts were filed in the Orphans' Court. (R. 7a–8a.)

Paragraph 4 of the decedent's will was as follows (R. 8a):

> I give and bequeath to my wife, Kathryn S. Fuller, for and during the term of her natural life, all the furniture, pictures or other articles contained in my home situate in the Borough of Dalton and Township of North Abington, County of Lackawanna, or elsewhere, also all horses, cattle, or other animals, carriages, harnesses, and motor vehicles owned by me at the time of my death. I also give, devise and bequeath to my wife for and during the term of her natural life my said home in the Borough of Dalton and Township of North Abington, together with the grounds and other appurtenances thereto and the equipment thereof.

All of the residue of his estate he gave the trustees upon the following trusts (R. 8a–9a):

> (a) To separate and set aside from the rest of my estate one portion thereof sufficient to produce an income of fifty thousand ($50,000.00) dollars annually, and to use said income or so much thereof as may be needed for the maintenance and opera-

tion of my home known as "Overlook" situate partly in the Borough of Dalton and partly in the Township of North Abington, as aforesaid including the grounds and other appurtenances and all things incident thereto, for and during the term of the life of my wife, Kathryn S. Fuller. It shall be so maintained and conducted after the death of my wife out of said fund also as long as any one of my sons may so desire; but if one of my three sons should not desire it so maintained and conducted only two-thirds (⅔) of said fund shall be used annually for said purpose and the remainder shall become part of the trust funds hereinafter mentioned; and if two of my three sons do not desire it so maintained and conducted only twenty-five thousand ($25,000.00) dollars of said income shall be used annually for said purpose and the remainder shall become part of the trust funds hereinafter mentioned;

(b) If at any time during the life of my wife, Kathryn S. Fuller, she and all my sons shall desire that said home, together with the grounds and appurtenances and things incident thereto, be sold, she and my trustees shall sell the same and the proceeds of said sale shall become part of my trust funds hereinafter mentioned, in the same proportion as hereinafter set forth;

(c) If after the death of my wife at any time my three sons, or they or he then surviving, shall decide to sell said home and grounds and appurtenances and things in-

> cident thereto, my trustees shall sell the same and divide and distribute the proceeds equally among my son or sons then living and the children of any surviving son or sons per stirpes * * *.
>
> * * * * *

The remainder of his estate was given in trust during his wife's life in part to her and in part to his three sons, with appropriate provision for distribution on the death of the wife (R. 9a–10a).

One of the assets owned by the decendent at the time of his death was his home mentioned in paragraph 4 of his will. It was a country estate called "Overlook". It had been the family home since 1905 when the decedent's father acquired it. It consisted of about 518 acres divided as follows (R. 10a):

Description:	Acres
Pasture and cultivated land	150
Landscaped grounds and lawn	20
Timber land	204
Unimproved land	60
Lake	84

The main house on the property is large. A flower conservatory is attached to the house. The house has been occupied, at all times material hereto, by the decedent's widow. All of the decedent's three sons are married. They, with their families since their marriages in 1929, 1932, and 1934, have occupied three other houses on the property separate from the main house. No rent is paid by any of the four who are executors.

Another house on the property has been rented to an employee of International Salt Company at $40 per month. There are also a number of houses and living quarters for employees and servants, a large trophy house, an indoor heated swimming pool, a Japanese tea garden, a frame boat house, a tennis court, and farm buildings on the property. There are three miles of 14-foot improved hard roads on the property. (R. 10a.)

The operation of Overlook during the life of the decedent and thereafter has always cost a substantial amount over and above the small income from the property (R. 10a).

The Fullers pay the expenses of their own households, such as food bills and servants' wages. The three brothers were respectively 36, 40, and 43 years of age in June 1947. (R. 10a.)

The executors paid the following amounts during the taxable years in connection with the Overlook property (R. 10a–11a):

	1942	1943
Pay roll	$18,679.43	$18,477.20
Light and coal	5,464.85	5,275.11
Horses and feed	1,610.00	3,902.23
Sundry expenses and supplies	1,116.64	981.15
Farm expense and equipment	1,860.07	2,610.95
Greenhouses and gardens	1,591.22	1,403.61
Auto repairs, etc	575.69	244.55
Oil and gas	1,556.80	556.78
Repairs and maintenance	575.69	2,147.91
Total	33,030.39	35,599.49

The totals shown above were not claimed as deductions on the returns filed for the estate for the years 1942 and 1943 (R. 11a).

The expenses relating particularly to the farming operations on Overlook, included in the figures shown above, were as follows (R. 11a):

	1942	1943
Labor	$11,443.18	$11,505.72
Feer	780.90	1,475.61
Seed, plant and trees	1,620.42	1,401.60
Supplies	1,042.11	1,000.30
Repairs equipt	244.47	188.67
Fertilizers and lime	420.63	178.00
Gasoline and other fuel	382.57	232.37
Insurance on prop	1,565.48	362.88
Water, elec. and telephone	1,634.21	1,554.08
Freight and trucking	50.73	19.85
Rental paid	150.00	150.00
Misc. expense	399.82	256.30
Memberships and assns	10.00	9.75
Tree sprays	——	480.75
Repair and maintenance bldgs	1,743.83	1,593.97
Depreciation	2,580.23	2,589.83
Total expenses	24,068.58	22,999.68

Income from rentals, and sales of produce and junk in the amount of $1,055.33 for 1942 and $2,352.13 for 1943, together with depreciation on farm buildings and equipment in the amount of $2,580.23 for 1942 and $2,589.83 for 1943 were used in connection with the farm expenses listed above to arrive at net farm loss of $23,013.25 for 1942 and $20,647.55 for 1943 which were deducted on the returns filed for the estate (R. 11a–12a).

The principal farming activity on Overlook has been to provide pasture and other food for a herd of dairy cows. The herdsman was given all of the revenue from the sale of dairy products, including that sold to the Fullers. He took

care of the herd and also spent some time working on the farm. He was not paid any wages. Most of the dairy products produced by the herd have been bought by the Fullers and their families from the herdsman at market prices. Excess dairy and farm products, if any, were sold to the public. The Fuller family usually took about 75% and about 25% was usually sold to the public. (R. 12a.)

About sixty acres of Overlook were sold at some time not disclosed by the record for about five or six thousand dollars. No sustained effort was ever made to sell any of the remainder of the property and no offer to buy any of it was ever received. (R. 12a.)

The Commissioner, in determining the deficiencies, disallowed the farm losses with the explanation that the loss from the operation of the farm was a personal expense not deductible for income tax purposes (R. 12a).[1] The Tax Court upheld the Commissioner's determination (R. 12a–16a) and the Court of Appeals affirmed, *per curiam*, upon the Tax Court's opinion (R. 30).

ARGUMENT

1. The holding of the courts below that the farm and residential property on which the widow

[1] The Tax Court seems to have used the term "losses" in a loose sense comprehending "expenses." In any event, the petitioners make no claim to a loss deduction under Section 23 (e), Appendix, *infra*, p. 14.

and the other executors resided were operated and maintained for their personal use and enjoyment and that the expenses incurred were not ordinary and necessary to manage, conserve, or maintain property held for the production of income so as to be deductable under Section 23 (a) (2), Internal Revenue Code, Appendix, *infra,* p. 13, or in connection with a business so as to be deductible under Section 23 (a) (1), Appendix, *infra,* p. 13, was clearly correct. Section 23 (a) (1) and (2) requires that the expenses be both "ordinary and necessary" (*Welch* v. *Helvering,* 290 U. S. 111). Here, the Tax Court concluded (R. 14a) that, there being no evidence to indicate that any effort was made to limit expenses to those necessary to conserve and maintain the property for any use incident to the administration of the estate, the "expenses were not ordinary or necessary expenses of the estate" (R. 13a).

The farm and property here involved were found to have been used "as a comfortable country estate" without any intention or expectation of deriving profit or income therefrom (R. 14a). Certainly when as here, the transactions were not carried on "*primarily* for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income" (Regulation 111, Section 29.23 (a)–15 (2) (b), Appendix, *infra,* p. 16, italics supplied), the expenses incident thereto

are not allowable deductions. The decision below is therefore in complete accord with the decided cases and the Treasury Regulations. *Trust of Bingham* v. *Commissioner,* 325 U. S. 365; *United States* v. *Pyne,* 313 U. S. 127, 131–132; *Coffey* v. *Commissioner,* 141 F. 2d 204, 205 (C. A. 5th); *Union Trust Co.* v. *Commissioner,* 54 F. 2d 199 (C. A. 6th); *Deering* v. *Blair,* 23 F. 2d 975 (C. A. D. C.); Regulations 111, Sec. 29.22 (a)–7, 29.23 (a)–1, 29.23 (a)–11, and 29.23 (a)–15, Appendix, *infra,* pp. 14–17.

2. The alleged conflict between the decision below and *Trust of Bingham* v. *Commissioner,* 325 U. S. 365, is non-existent. The taxpayer (Pet. 13) misconstrues the *Bingham* case as permitting the deduction of any ordinary expense incident to the duty of a trustee to hold and conserve property until final distribution. From this it is argued that the decedent's will here imposed the duty on the trustees to operate and maintain the realty in question and therefore expenses incurred (by the executors) in fulfilling this duty are likewise deductible. The *Bingham* case, however, involved property held by trustees "for the production of income", and it was ruled, *inter alia,* that the property did not cease to be so held when the trust term reached its expiry date. Here, however, the Tax Court found that the expenses in question were "for the quite different purpose of providing a country estate as a comfortable living place for the four indi-

viduals who are also executors." (R. 14a.) Since the *Bingham* case is grounded on a determination that property be held for the production of income, the taxpayer can find no support in the application of that rule to this case where the finding, apparently not now disputed, is that the property was not held for the production of income and the expenses were, in any event, neither ordinary nor necessary. See *supra*, p. 9.

3. The taxpayer asserts (Pet. 13) that the Tax Court has failed either in its Findings of Fact or its Opinion to make specific findings with respect to the alternative issue that the expenses involved are deductible under Section 23 (a) (1) as "ordinary and necessary expenses paid in carrying on the business of farming." But the Tax Court's lengthy discussion (R. 13a–15a) of the non-deductibility of (R. 13a) "annual farm losses as ordinary and necessary expenses of a business" in the light of its conclusion (R. 14a) that there was no evidence to "indicate that any effort was ever made to operate this farm profitably" and its quotation (R. 14a–15a) from the case of *Union Trust Co.* v. *Commissioner*, 18 B. T. A. 1234, which it thought apposite in view of the absence from the decedent's will of any indication that the farm be operated on a commercial basis, demonstrate the infirmity of the objection. The opinion may, of course, "perform the office of a finding of facts" (*Olson* v. *Commissioner*, 67 F. 2d 726, 728 (C. A. 7th), certiorari denied, 292 U. S.

637) and may be read in its entirety to determine the import of the decision and the facts on which it is based. (*Janeway* v. *Commissioner*, 147 F. 2d 602 (C. A. 2d); *Emerald Oil Co.* v. *Commissioner*, 72 F. 2d 681 (C. A. 10th); *Insurance & Title Guarantee Co.* v. *Commissioner*, 36 F. 2d 842 (C. A. 2d), certiorari denied, 281 U. S. 748). The opinion as a whole leaves no doubt as to the finding of the Tax Court against the taxpayer on the alternative issue. *United States* v. *Pyne*, 313 U. S. 127, cited by the taxpayer, is, with respect to this question, patently distinguishable on its facts.

CONCLUSION

The decisions below are correct and in harmony with the decided cases. There is no conflict and no need for further review. The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 1949.

APPENDIX

INTERNAL REVENUE CODE

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In General.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

* * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business;

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

(a) [as amended by Sec. 127 (b) of the Revenue Act of 1942, supra] *General Rule.*—In computing net income no deduction shall in any case be allowed in respect of—

(1) Personal, living, or family expenses, except extraordinary medical expenses deductible under section 23 (x);

* * * * *

(26 U. S. C. 1946 ed., Sec. 24.)

TREASURY REGULATIONS 111, PROMULGATED UNDER THE INTERNAL REVENUE CODE

SEC. 29.22 (a)–7. *Gross Income of Farmers.*—

* * *

* * * * *

* * * A person cultivating or operating a farm for recreation or pleasure, the result of which is a continual loss from year to year, is not regarded as a farmer.

* * * * *

SEC. 29.23 (a)–1. *Business Expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business * * *

* * * * *

SEC. 29.23 (a)–11. *Expenses of Farmers.*— * * * If a farm is operated for recreation or pleasure and not on a commercial basis, and if the expenses incurred in connection with the farm are in excess of the receipts therefrom, the entire receipts from the sale of products may be ignored in rendering a return of income, and the expenses incurred, being regarded as personal expenses, will not constitute allowable deductions. * * *

SEC. 29.23 (a)–15 [as amended by T. D. 5331, 1944 Cum. Bull. 98, and T. D. 5513, 1946–1 Cum. Bull. 61]. *Nontrade or Nonbusiness Expenses*— (a) *In General.*—Subject to the qualifications and limitations in chapter 1 and particularly in section 24, an expense may be deducted under section 23 (a) (2) only upon the condition that:

(1) it has been paid or incurred by the taxpayer during the taxable year (i) for the production or collection of income which, if and when realized, will be required to be included in income for Federal income tax purposes, or (ii) for the management, conservation, or maintenance of property held for the production of such income; and

(2) it is an ordinary and necessary expense for either or both of the purposes stated in (1) above. * * *. The expenses, however, of carrying on transactions, which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby,

or recreation are not allowable as nontrade or nonbusiness expenses.

Expenses, to be deductible under section 23 (a) (2), must be "ordinary and necessary," which presupposes that they must be reasonable in amount and must bear a reasonable and proximate relation to the production or collection of taxable income or to the management, conservation, or maintenance of property held for the production of income.

(b) Except for the requirement of being incurred in connection with a trade or business, a deduction under this section is subject to all the restrictions and limitations that apply in the case of the deduction under section 23 (a) (1) (A) of an expense paid or incurred in carrying on any trade or business. This includes restrictions and limitations contained in section 24. * * *

Capital expenditures, and expenses of carrying on transactions which do not constitute a trade or business of the taxpayer and are not carried on for the production or collection of income or for the management, conservation, or maintenance of property held for the production of income, but which are carried on primarily as a sport, hobby, or recreation are not allowable as nontrade or nonbusiness expenses. The question whether or not a transaction is carried on primarily for the production of income or for the management, conservation, or maintenance of property held for the production or collection of income, rather than primarily as a sport, hobby, or recreation, is not to be determined solely from the intention of the taxpayer but rather from all the circumstances of the case, including the record of prior gain or

loss of the taxpayer in the activity, the relation between the type of activity and the principal occupation of the taxpayer, and the uses to which the property or what it produces is put by the taxpayer.

* * * * *

Ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held for use as a residence by the taxpayer are not deductible. However, ordinary and necessary expenses paid or incurred in connection with the management, conservation, or maintenance of property held by the taxpayer as rental property are deductible even though such property was formerly held by the taxpayer for use as a home.[1]

[1] Section 29.23 (a)–15 (b) of Treasury Regulations 111 was amended by striking out the fifth paragraph thereof and substituting this paragraph in lieu thereof. See T. D. 5331, 1944 Cum. Bull. 98 (approved February 9, 1944). It was also later amended by striking out the sixth, seventh, eighth and tenth paragraphs thereof and substituting, after the fifth paragraph, a single new paragraph in lieu thereof, which is immaterial herein. See T. D. 5513, 1946–1 Cum. Bull. 61–62 (approved May 14, 1946). Hence, the last two paragraphs of Section 29.23 (a)–15 (b) of Treasury Regulations 111, as quoted in the Record (pp. 3a–4a), are no longer in force.

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